Economic Outlook

B4750-2

Irving Trust

Irving Trust Company
One Wall Street
New York, NY 10015

Economic Research &
Planning Division

December 1984

Recent data reflect the slowdown in the economy as well as the economy's resiliency. Real growth is expected to remain subdued through the first quarter of next year. By the spring, however, the economy will likely show renewed vigor. Real GNP is expected to rise 3.8% from the fourth quarter of 1984 to the fourth quarter of 1985, following an estimated (fourth-quarter to fourth-quarter) increase of 5.4% in 1984 and an increase of 6.4% in 1983.

By late summer and early fall, the signs of weakness in the economy were widespread. Retail sales appeared essentially flat from April to October, while the index of leading economic indicators, housing starts, and factory orders were falling. Recently released reports for November, however, showed surprising strength. Retail sales rose 1.8% from October to November, with the improvement evident in most types of stores.

The slowdown in the economy partially reflects inventory imbalances that developed during the year. As an illustration of the problem, department stores' inventories were 22.2% higher in October than a year earlier, while sales had risen only 8.9% during the same period. With the notable exception of the auto industry, excessively high inventories have become evident across a wide spectrum of industries. As a result, real growth will be dampened for another quarter or so as firms hold back on orders and curtail production to bring inventories into better balance with sales. Once this mini-inventory cycle is completed, the economy will likely show improved growth. A major drag on the economy next year, however, will be further enlargement of the U.S. merchandise trade deficit.

Real growth will benefit next year from recent declines in interest rates. Mortgage rates have already declined substantially, and home sales have responded to the improved financing conditions. A wild card in the near-term outlook, however, is the Treasury Department's recent tax reform proposal. Although mortgage interest would remain deductible for the principal residence and tax rates would be lowered, property taxes and state and local income taxes would no longer be deductible. This change would likely raise the tax liabilities of residents in high tax areas who currently itemize. In any case, a major uncertainty has been introduced that may cause some people to defer the decision to purchase a home until the situation is clarified. A similar argument applies to business capital spending.

In sum, the U.S. economy is sending mixed signals, showing weakness as well as residual strength. As for next year, monetary policymakers will continue to have unusual flexibility in sustaining economic expansion in the U.S., since the recovery outside the U.S. will likely remain subdued and inflation rates will likely remain relatively low. Growth in Western Europe is expected to continue below par, while many parts of Latin America will continue to experience severe economic problems. As a result, neither the development of capacity constraints nor an extended increase in commodity prices is likely. This is not the type of situation usually evident in advance of recessions. Consequently, the present U.S. economic recovery may yet prove to be of unusually long duration.

Bernard Schoenfeld

Irving Trust

Economic Forecast

Percent Changes at Annual Rates

	Actual			1984	Forecast			1985	Actual	Forecast	
	I	II	III	IV	I	II	III	IV	1982-1983	1983-1984	1984-1985
Gross National Product	14.9	10.7	5.7	7.0	6.7	9.7	9.2	8.5	7.7	10.8	7.9
Real GNP	10.1	7.1	1.9	2.9	2.3	5.3	4.4	3.2	3.7	6.8	3.5
GNP Price Deflator	4.4	3.3	3.7	4.0	4.3	4.2	4.6	5.1	3.8	3.8	4.2

	Actual	Forecast	Actual	Forecast	
	1984:III	1984: IV	1982-1983	1983-1984	1984-1985
Consumer Spending	4.9%	7.1%	8.6%	8.7%	7.8%
Durable Goods	-2.7	5.0	14.2	13.7	6.6
Nondurable Goods	1.3	5.3	5.8	7.0	5.8
Services	9.9	9.0	9.4	8.6	9.6
Business Capital Spending	17.9	11.0	0.9	21.0	13.5
Structures	9.0	12.8	-8.7	16.3	12.9
Equipment	23.0	10.0	7.6	23.7	13.9
Residential Investment	-0.5	-6.0	44.6	16.3	3.8
			1983	1984	1985
Change in Inventories	$68.5b.	$54.7b.	$-13.5b.	$61.9b.	$45.8b.
Net Exports of Goods and Services	$-89.9b.	$-81.0b.	$-8.3b.	$-70.3b.	$-88.8b.
			1982-1983	1983-1984	1984-1985
Government Purchases	10.3%	9.7%	5.4%	9.1%	10.2%
Federal	9.0	9.5	4.2	9.1	12.8
Defense	-0.7	10.8	11.7	9.8	11.0
Other	41.1	6.0	-12.7	6.7	18.0
State & Local	11.1	9.9	6.2	9.0	8.5
Corporate Profits Before Tax	-1.6*	-1.7*	22.8	15.0	5.8
Corporate Profits After Tax	-2.3*	-2.1*	21.6	13.5	6.5
Plant and Equipment Expenditures	16.1F	11.9	-4.8	14.5	11.1
Real Final Sales#	-0.5	4.6	3.2	4.8	4.0
Real Disposable Personal Income	3.9	3.5	3.5	6.7	4.0

Economic Indicators	Recent Data			Actual	Forecast	
	Sept.	Oct.	Nov.	1982-1983	1983-1984	1984-1985
Consumer Price Index**	4.8%	4.8%	n.a.	3.8%	4.7%	4.8%
Producer Price Index for Finished Goods**	-2.4	-2.4	6.0	0.6	1.9	4.7
Industrial Production	-7.2	-4.8	4.8	6.5	10.7	4.0
Retail Sales##	1.5	0.1	1.8	9.3	10.1	7.8
				1983	1984	1985
Auto Sales (millions of units, a.r.)	10.3	9.7	9.8	9.2	10.4	10.6
Housing Starts (millions of units, a.r.)	1.68	1.52	n.a.	1.70	1.78	1.66
Unemployment Rate	7.4	7.4	7.2	9.6	7.6	6.8
Merchandise Trade Deficit (a.r.)	$151.8b.	$-110.2b.	n.a.	$69.4b.	$130.0b.	$148.0b.

Unless noted otherwise, all data are period-to-period percent changes at annual rates, derived from seasonally adjusted data.

December 17, 1984

#GNP less change in inventories, both in real terms.
##Monthly percent changes are not annualized.
*Year-over-year percent changes.
**Annual percent changes are December to December (not seasonally adjusted).
$b. = billions a.r. = annual rate F = Forecast